United States Court of Appeals

for the Second Circuit

PETITION FOR REHEARING EN BANC

75-6111

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

Docket No.
75-6111

-against-

UNIVERSAL MAJOR INDUSTRIES CORP., JAMES G. DUNCAN, TRANSAMERICAN PETROLEUM CORPORATION, ROY M. HORSEY, BANNER OIL AND GAS FUNDS, INC., IAN McCARTNEY, EDWARD G. GEDALECIA,

Defendants,

ARTHUR J. HOMANS,

Defendant-Appellant.

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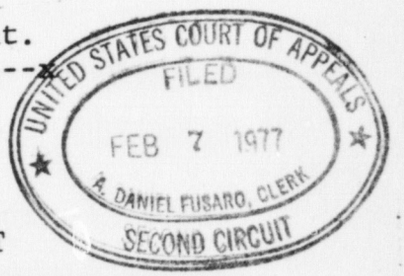

PETITION FOR REHEARING
AND
SUGGESTION OF APPELLANT THAT
REHEARING BE HEARD IN BANC

Defendant-Appellant, Arthur J. Homans, respectfully petitions this Court under FRAP 40 for rehearing of its decision decided December 16, 1976, in the above-entitled appeal and suggests under FRAP 35(b) that rehearing, if granted, be in banc. Appellant's reasons for requesting such relief are set forth below.

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In an opinion by Van Graafeiland, C.J., joined by Lumbard, S.C.J., and Bonsal, D.J. (sitting by designation)* the Court held as follows:

I. The Decision Upholding Civil Aiding and Abetting Liability

(1) It held that Section 5 of the Securities Act authorizes the imposition, in a civil injunction action by the SEC, of so-called "secondary" liability for "aiding and abetting" against an attorney for the issuer of unregistered securities in violation of that section. It so held despite the following circumstances and arguments:

(A) § 5(a)(1) makes it unlawful only for "any person, directly or indirectly, ... to sell" an unregistered and nonexempt security in interstate commerce. There is no finding in this case that appellant "sold" any securities, directly or indirectly. Writing opinion letters is not indirect "selling" within the meaning of the statute.

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* Copy attached as an exhibit

See, SEC v. Timetrust, 142 F.2d 744 (9th Cir. 1944), reversing, 28 F. Supp. 34, 43 (N.D. Calif. 1939).

(B) Nothing in the legislative history of Section 5 indicates any intent on the part of Congress to impose liability upon any but "primary" violators named in the Securities Act, e.g., issuers, officers and directors of issuers, underwriters, etc. Indeed, where Congress intended to impose "secondary" liability upon persons not directly or primarily engaged in the selling of securities, it did so expressly in the securities statutes. See, § 15, "Liability of Controlling Persons," and 1934 Act, § 20.

(C) With respect to criminal violations of the securities laws, liability for "aiding and abetting" may be imposed by application of a specific federal statute, in existence when the securities laws were first enacted. 18 U.S.C. § 2 (1970). There is no such statutory authority

for the imposition of civil aiding and abetting liability. Indeed, the SEC admitted in its main brief on appeal (p. 32, n.36) that it has been lobbying unsuccessfully for more than 20 years for the passage of a civil aiding and abetting statute. In the absence of such a statute, the December 16 decision upholding the existence of civil aiding and abetting liability without supporting Supreme Court authority constitutes an impermissible act of judicial legislation in an area where Congress has repeatedly and intentionally refused to act despite intense urging from the Commission. If this Court wishes to engage in such "judicial activism" where congressional authority is lacking, we respectfully submit that it should be done in banc by decision of all of the active circuit judges and not by a panel including only one such judge. Of the eight active judges in the Second Circuit, only one concurred in this

extraordinary, far-reaching, and already highly controversial decision.

(D) In Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), the Supreme Court adopted a strict and limited reading of § 10(b) of the 1934 Act and indicated clearly that the lower federal courts are not to expand the reach of liability under the securities laws beyond the scope defined by a literal reading of the statutory language. The decision in this case clearly fails to follow the teaching of Hochfelder by adopting an expansive view of liability under Section 5. Moreover, in Footnote 7 [425 U.S. at 191-92 n.7], the Hochfelder decision indicates that it is an open question in the Supreme Court "whether civil liability for aiding and abetting is appropriate" under § 10(b) and Rule 10b-5. Appellant maintains that it should be an open question in this Court under § 5 as well, to be decided by rehearing in banc. The December 16 panel did not disagree with the

proposition that the Supreme Court considers this an open question. It simply (i) declined, without stating any persuasive reasons, to reconsider the prior Second Circuit decisions upholding aiding and abetting liability* and (ii) stated, correctly, that "Hochfelder does not require us to overrule these decisions, and we decline to do so." In light of the Supreme Court's clear statement of this as an open question despite the existence of substantial circuit court authority, appellant submits that he is reasonably entitled to a more fully reasoned statement on the matter by this Court before he takes the issue to the Supreme Court.

(E) In this action, there was absolutely no purpose to be served by an injunction against attorney Homans after the defendant corporate issuers, corporate officials and securities

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* SEC v. Management Dynamics, Inc., 515 F.2d 801 (2d Cir. 1975); SEC v. Spectrum Ltd., 489 F.2d 535 (2d Cir. 1973); SEC v. North American Research & Dev. Corp., 424 F.2d 63 (2d Cir. 1970).

counsel had consented to the issuance of permanent injunctions against them. Appellant was thereafter in no position to sell any of the subject securities even if he had wanted to do so. Moreover, the SEC never alleged that there was any likelihood at all of Mr.Homans participating in any further acts in violation of Section 5.

II. The Holding That an Injunction May be Based Upon Negligence, Without Scienter; A Conflict With Other Circuits

(2) The panel held, relying upon cases cited in the footnote above, "that in SEC proceedings seeking equitable relief, a cause of action may be predicated upon negligence alone, and scienter is not required." But it acknowledged that the Second Circuit holdings in that respect are in conflict with those in at least two other circuits, the Sixth and District of Columbia.* It also acknowledged (in footnote 1) the "plausibility" of appellant's argument that negligent behavior is, by

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* SEC v. Coffey, 493 F.2d 1304, 1316 n.30 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975); SEC v. National Student Marketing, 402 F. Supp. 402, F. Supp. 641, 648-50 (D.D.C. 1975).

definition, inadvertent, and for the courts to issue injunctions against unintended behavior is at best pointless and calculated to make the courts look cruel, and the injunctive process punitive rather than preventive. Without stating any reason for rejecting this argument and, in substance, accepting it, the December 16 decision simply indicates, as an act of undocumented faith, that the relevant arguments were considered and rejected for good reason by the panels that rendered the prior relevant Second Circuit decisions. Examination of those decisions reveals absolutely no basis for the unsupported assumption stated by the panel. On this issue as well appellant is entitled, in fairness, to a more extensively reasoned discussion of the problem by the active judges of this Court.

III. The "Holding" That an Injunction May Be Issued, Where a Basis for Finding Scienter Exists, in the Absence of any Likelihood of Future Violations.

(3) The December 16 decision has recently been cited by the SEC to this Court as holding that an injunction against future securities law violations may properly be

issued by a district court in this circuit where the facts indicate absolutely no likelihood whatsoever of future violations by the defendant, provided there is a basis in the operative facts for a finding of scienter. We understand that the Commission made that or a similar argument in a recent motion seeking summary reversal of the decision in SEC v. Bausch & Lomb, Inc., CCH Fed. Sec. L. Rep. ¶95,722 (S.D.N.Y., 73 Civ. 2458, 9-16-76, Ward, J.). We are not convinced that the panel meant to have its decision stand for such a novel interpretation of the law, but such a proposition is at least reasonably arguable from the language of the opinion.

(A) The notion that an equitable injunction may be issued where there is no likelihood of any future violation of the statute represents a dramatic departure from the law as it has existed for decades under the securities statutes and conflicts directly with the language of § 20(b) of the 1933 Act, which authorizes the SEC to bring action only to prevent future violations. Before the Second Circuit adopts that as its

version of federal law, the issue should be reheard, preferably en banc.

(B) The issue whether scienter in the Hochfelder sense (intent to deceive, manipulate or defraud) or some close analogue thereof is required for the issuance of an injunction for "aiding and abetting" § 5 violations relates to two separate but highly volatile controversies: (i) the issue of scienter versus negligence and (ii) the issue of scienter as a substitute for a likelihood of future violation. If an injunction can be based upon a finding of scienter in past conduct of the defendant without any significant possibility of future violation, then this Circuit is faced with the unavoidable accusation and conclusion that it is authorizing the use of equitable injunctions purely to punish past acts and not to prevent future ones. Such a distortion and perversion of traditional principles of equity is intolerable and should not be permitted without reconsideration en banc

of the December 16 decision.*

(C) The December 16 decision contains a characterization of the decision below that is completely unjustified by and in conflict with the record. It is stated (p. 1005) that there was "ample support for Judge Tenney's conclusion that appellant should be permanently enjoined from doing business while he is in violation of SEC rules." First, Judge Tenney did not enjoin appellant from "doing business" as a securities attorney. He only enjoined him from committing future securities law violations, something the SEC admitted he was unlikely to do anyway. Second, Judge Tenney did not conclude that appellant "is in violation of SEC rules" at present. He concluded that appellant had aided and abetted others to violate such rules more than four years ago. There has not been even the suggestion or the suspicion of any such acts by appellant during

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* See, E. Brodsky, "Scienter in SEC Injunction Actions," N.Y.L.J. 1-19-77, p.1 (copy attached), and cases cited therein. See also, SEC v. Koracorp Industries, Inc., CCH Fed. Sec. L. Rep. ¶95, 532 (N.D.Calif. 3-26-76).

the entire four-year period that has now elapsed.

CONCLUSION

For all of the reasons set forth above and in appellant's brief and reply brief submitted on this appeal, the relief requested in this petition should be granted and this Court, sitting en banc, should review the decision of December 16 and the decision of the district court below.

Dated: New York, New York
January 28, 1977

BREWER & SOEIRO

By Bradley R. Brewer
Bradley R. Brewer
A Member of the Firm
Attorneys for Appellant
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(212) 777-4020

Certificate of Counsel

I hereby certify that I have examined the foregoing petition and present it to this Court in good faith, based upon my opinion that it is well-founded, and not for the purpose of delay.

Bradley R. Brewer
Bradley R. Brewer
Attorney for Appellant

CERTIFICATE OF SERVICE

The undersigned attorney for appellent does hereby certify that on January 29, 1977, I served the attached Petition for Rehearing upon Howard B.Scherer, attorney for Securities and Exchange Commission, by depositing two copies in the United States mails addressed to him at Securities and Exchange Commission, Washington, D.C. 20549.

Bradley R. Brewer

Bradley R. Brewer

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 133—September Term, 1976.

(Argued October 28, 1976 Decided December 16, 1976.)

Docket No. 75-6111

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

UNIVERSAL MAJOR INDUSTRIES CORP., et al.,

Defendants,

ARTHUR J. HOMANS,

Defendant-Appellant.

Before:

LUMBARD and VAN GRAAFEILAND, *Circuit Judges,*
BONSAL, *District Judge**

Action by the Securities and Exchange Commission to enjoin violations of § 5 of the Securities Act of 1933, 15 U.S.C. § 77e.

Appeal from the order of Judge H. Tenney, United States District Court for the Southern District of New York, granting a permanent injunction against appellant.

Affirmed.

* Of the Southern District of New York, sitting by designation.

BRADLEY R. BREWER, New York, N. Y. (Brewer & Soeiro, New York, N. Y., of Counsel), *for Defendant-Appellant.*

DAVID J. ROMANSKI, Assistant General Counsel for the S.E.C., Washington, D. C. (David Ferber, Solicitor to the Commission; Howard B. Scherer, of Counsel), *for Plaintiff-Appellee.*

VAN GRAAFEILAND, *Circuit Judge:*

The Securities and Exchange Commission commenced this action against appellant and seven other defendants, seeking injunctions for violations of the Securities Act of 1933 and the Securities Act of 1934. The other defendants consented to the entry of permanent injunctions against them. Following a trial in the Southern District of New York, Judge Tenney found that appellant had aided and abetted his client, Universal Major Industries Corporation (U.M.I.), in selling over three million shares of unregistered stock in violation of Section 5 of the Securities Act of 1933, 15 U.S.C. § 77e, and permanently enjoined him from further violations. We affirm.

U.M.I. became a publicly held corporation in 1954, and appellant was its general counsel from 1959 through 1973. In March 1967, U.M.I. sought to raise capital to expand its petroleum exploration and development operations. To avoid the registration requirements of the Securities Act of 1933 (the Act), U.M.I. decided to engage in a private placement of debentures, exempt from registration under Section 4(2) of the Act, 15 U.S.C. § 77d(2). Appellant advised that no registration would be required for the debentures so long as the number of transferees was small, they were provided with substantial information about

U.M.I. operations and they possessed sufficient expertise to evaluate that information.

Instead of complying with appellant's restrictive admonitions, the company issued almost $3,500,000 of its 6% convertible debentures to approximately 425 persons and $440,000 of its 7% convertible debentures to 26 persons. Realizing that U.M.I. had transgressed the boundaries of the Section 4(2) exemption requirements, appellant instructed it to have the debentures registered with the S.E.C. U.M.I. retained attorney Edward Gedalecia to process this registration, but this was never accomplished.

Between March 1967 and February 1973, U.M.I. also issued roughly three million shares of unregistered common stock. These were used for the conversion of the debentures and the payment of interest, in lieu of cash thereon; for the purchase of interests in oil and gas properties; and in exchange for services and cash. In addition, over one-half million shares, issued to controlling shareholders, were sold by them to 134 investors. Before U.M.I.'s stock could be transferred in any of these transactions, its stock transfer agent, Continental Stock Transfer Corporation (Continental), required an opinion letter from U.M.I.'s designated counsel stating that the transfer was legal. The charges against appellant are based on the letters which he, as designated counsel, wrote in compliance with Continental's requirement.

Appellant wrote some 118 letters in connection with U.M.I. transfers of stock to debenture holders who exercised their conversion privilege or consented to receive stock in lieu of cash interest payments, of which the following is a typical example:

> I refer to the attached letter of instructions from the authorized officers of Universal dated May 13th, 1968, with reference to the issuance of common stock of

Universal upon a conversion of certain outstanding debentures of Universal.

With respect to the issuance of shares in accordance with the conversion provisions of the debentures, I am enclosing herewith copy of a letter of opinion from (Gedalecia), who (is) special counsel for Universal, bearing date March 11th, 1968.

The undersigned renders no opinion as to the original sale or issuance of the debentures which are presently presented for conversion, but I rely on the opinion of (Gedalecia) to the effect that the conversion of the debentures and the issuance of the stock upon such conversion, in and of itself, does not constitute a violation of the Securities Act.

However, I call to your attention that it will be necessary to place an appropriate investment stop on your records and to place an appropriate legend upon the face of the certificates of stock to be issued. (Emphasis added).

Each of these letters was accompanied by a letter from attorney Gedalecia to U.M.I. containing, in substance, the following opinion:

In view of the fact that the debentures and the underlying stock into which they are convertible were in our opinion, sold in transactions violative of Section 5 of the Securities Act of 1933, as amended (as well as the Trust Indenture Act) the conversions at this time, as proposed, would not constitute additional violations of the Act.

Despite appellant's obvious attempt to avoid a personal commitment in these letters, the District Court rejected his contention that they were simply letters of transmittal.

The District Judge said that, if they were not expressions of opinion, "it is difficult to understand why such letters were written on Homans' stationery (or, indeed, why Homans, an attorney, wrote any such letters), why such letters directed the issuance of restricted and appropriately legended stock, and why such letters contained a statement indicating that Homans *relied upon* the opinion of another." The District Judge found that the letters could reasonably have been understood by their recipients as an expression of appellant's own opinion concerning the legality of the issuances which they covered, and this finding was not clearly erroneous.

Appellant also wrote 88 letters in connection with other stock transfers, which were unaccompanied by a letter from Gedalecia and in which appellant clearly stated his own opinion as to the legality of the transactions. These letters, the District Judge said, speak for themselves. We agree.

Appellant's principal argument in this Court is based upon a footnote in the recent case of *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 191-92 n.7 (1976), where the Court said:

> In view of our holding that an intent to deceive, manipulate, or defraud is required for civil liability under § 10b(5) and Rule 10b-5, we need not consider whether civil liability for aiding and abetting is appropriate under the section and the Rule, nor the elements necessary to establish such a cause of action.

Appellant construes this statement to mean that the Court feels (a) there should be no liability for aiding and abetting a Section 5 violation, or (b) if such liability may be found to exist, it must be based upon scienter, rather than negligence. We think that appellant reads more than was written.

In order to accomplish the broad remedial purposes of the Securities Acts, *Affiliated Ute Citizens of Utah* v. *United States*, 406 U.S. 128, 151 (1971), there are compelling reasons to impose secondary liability in Section 5 actions. By its terms, Section 5 makes it unlawful, "directly or indirectly", to sell unregistered stock. The heart of this prohibition would be cut away if the only person covered by its provisions was the individual who actually consummated the sale. We do not believe the Supreme Court intended that those who play an indispensable role in the sale, as appellant did here, should not be subject to SEC initiated, injunctive restraint.

Our prior decisions clearly establish that injunctive relief is proper against aiders and abettors of Section 5 violations. *See SEC* v. *Management Dynamics, Inc.*, 515 F.2d 801 (2d Cir. 1975); *SEC* v. *Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973); *SEC* v. *North American Research & Development Corp.*, 424 F.2d 63 (2d Cir. 1970). *Hochfelder* does not require us to overrule these decisions, and we decline to do so.

In these same decisions, we also made it clear that in SEC proceedings seeking equitable relief, a cause of action may be predicated upon negligence alone, and scienter is not required. While this rule has not met with universal approval, *see, e.g., SEC* v. *Coffey*, 493 F.2d 1304, 1316 n.30 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975); *SEC* v. *National Student Marketing Corp.*, 402 F.Supp. 641, 648-50 (D.D.C. 1975), it is nonetheless the law of this Circuit.[1]

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1 Appellant argues with some plausibility that courts should not seek to eliminate negligent behavior by enjoining against it, because, by definition, negligence is inadvertent and unintended. Moreover, if the intent or knowledge required for a finding of contempt is no greater than that required for the initial violation of the statute, *see United States* v. *Ell*, 298 F.Supp. 1221, 1236 (D. Conn. 1969), a defendant may find himself in contempt of court for conduct which is merely inadvertent and unintended. We are sure, however, that these considerations were not overlooked by the prior panels whose holdings we follow.

Hochfelder, which was a private suit for damages, does not undermine our prior holdings. Indeed, our decision need not rest on our rejection of appellant's negligence-scienter argument, because the District Court found that appellant in some circumstances knew and in other circumstances had reason to know that his client was engaging in illegal transactions with the aid of appellant's letters and that appellant's acts were performed with knowledge or reckless disregard of the truth. This, we have held, is sufficient to establish scienter. *Lanza* v. *Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973).

Appellant also contends that, before he can be held liable for aiding and abetting, there must be proof, not only that securities were offered for sale, but also that such sales were made as part of a single, definable and integrated offering. He says that, because the sales in the instant case were made as a series of "separate, isolated and individual unrelated transactions over a period of six years," they did not meet this latter test.

The integrated offering concept sometimes is relied upon where partial exemption from registration is claimed under §§ 3(a)(9) and 3(a)(11), 15 U.S.C. § 77(a)(9) and § 77(a)(11).[2] *See* 1 Loss Securities Regulations, 577-78, 591-95 (1961); *Hill York Corp.* v. *American Int'l Franchises, Inc.*, 448 F.2d 680, 689-90 (5th Cir. 1971). This is done to prevent the fragmentization of what is basically a single issue of stock in order that the benefit of these exemptions might be claimed. *Cf. Shaw* v. *United States*, 131 F.2d 476, 480 (9th Cir. 1942).

In any event, the District Court's finding that appellant acted "with knowledge or reckless disregard of the truth" removes the props from under appellant's basic argument.

2 Section 3(a)(9) exempts securities exchanged by the issuer with existing security holders involving no payment or commission or similar remuneration, and Section 3(a)(11) exempts securities which are part of an exclusively intra-state offering.

It does not follow, however, that the Commission must establish the existence of an integrated offering where a Section 5 violation is claimed. The focus of inquiry in such cases is not so much upon the nature of the offering as upon the need for protection of the class of offerees; *i.e.*, whether they have the information which a registration would disclose, or have access to it. *Gilligan Will & Co.* v. *SEC*, 267 F.2d 461, 466 (3d Cir. 1959). The need for this protection remains the same whether sales are concentrated in a short period of time or made as part of a series of isolated transactions. Although the size of the offering, the number and relationship of the offerees, and the manner in which the offering is made are factors which may be considered in determining whether the offering is public or private, *Hill York Corp.* v. *American Int'l Franchises, Inc.*, *supra*, 448 F.2d at 687-89, these are simply criteria which are helpful in arriving at the ultimate determination of whether the purchasers or offerees require the protection of the Act. *Id.* at 689; *United States* v. *Custer Channel Wing Corp.*, 376 F.2d 675, 678 (4th Cir.), *cert. denied*, 389 U.S. 850, *rehearing denied*, 389 U.S. 998 (1967); *Andrews* v. *Blue*, 489 F.2d 367, 373-74 (10th Cir. 1973).

Finally, appellant argues that the District Court abused its discretion in issuing the permanent injunction because the SEC failed to make the required showing of a reasonable likelihood that the wrong would be repeated. *SEC* v. *Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1100 (2d Cir. 1972); *SEC* v. *Culpepper*, 270 F.2d 241, 249 (2d Cir. 1959). In support of his contention, appellant points out that he ceased his association with U.M.I. over three years ago and states that the SEC has not even suspected him of illegal activity since that time.

A District Judge is vested with a wide discretion when an injunction is sought to prevent future violations of the securities laws. *SEC* v. *Manor Nursing Centers, Inc.*, *supra*,

458 F.2d at 1100, and "cessation of illegal activity does not *ipso facto* justify the denial of an injunction." *SEC* v. *Management Dynamics, Inc., supra,* 515 F.2d at 807. The factors which he may consider include the likelihood of future violations, the degree of scienter involved, the sincerity of defendant's assurances against future violations, the isolated or recurrent nature of the infraction, defendant's recognition of the wrongful nature of his conduct, and the likelihood, because of defendant's professional occupation, that future violations might occur. *SEC* v. *Management Dynamics, Inc., supra,* 515 F.2d at 807; *SEC* v. *Spectrum, Ltd., supra,* 489 F.2d at 542; *SEC* v. *Manor Nursing Centers, Inc., supra,* 458 F.2d at 1101-02. On the basis of these criteria, we find ample support for Judge Tenney's conclusion that appellant should be permanently enjoined from doing business while he is in violation of SEC rules.

The judgment is affirmed.

Corporate And Securities Litigation

By Edward Brodsky

Mr. Brodsky, whose column is a regular feature of the Law Journal, is a member of the firm of Spengler Carlson Gubar Churchill & Brodsky.

Scienter in SEC Injunction Actions

The SEC is asking the Court of Appeals for the Second Circuit to summarily reverse the District Court's *Bausch & Lomb*[1] decision in which Judge Robert J. Ward, relying on *Ernst & Ernst v. Hochfelder*,[2] said that proof of scienter is a necessary element in an SEC injunction action. Before *Hochfelder* the Second Circuit held that proof of negligence was sufficient to sustain SEC injunction actions, as distinguished from private actions for damages, in which scienter was required,[3] but Judge Ward said that *Hochfelder* required a different result.

Basis of SEC Request

The Commission's request for the "extraordinary remedy" of "summary reversal", — reversed without briefing or argument by the defendant[4] — is based upon "the district court's attempts to overrule the law of this Circuit"[5] and on the Second Circuit's opinion in *SEC v. Universal Major Industries, Corp.*,[6] decided shortly after Judge Ward's decision, which, according to the SEC, holds that "negligence alone is sufficient to support an action by the Commission for injunctive relief based on violations of the federal securities laws."[7]

There are several reasons why the SEC's request for summary reversal may be rejected or may not result in a Court of Appeals decision on the merits of this important issue, which, if ultimately decided against the Commission, will dull one of its most effective enforcement tools.

Reasons Listed

First, as the Commission alleges,[8] the appeal may turn on issues, such as materiality and standing, in addition to the scienter question.

Second, while Judge Ward said that *Hochfelder* required proof of scienter in SEC injunction actions, he also found that there was no likelihood of a future violation by the defendant and, on that additional ground, held that no injunction should issue. Therefore, the Court of Appeals may find that Judge Ward's opinion about scienter was dicta and there is no reason to remand the case because the holding is correct.

Third, the Court of Appeals' statement in *Universal Major Industries, Corp.*, relied upon by the Commission in its request for summary reversal, that "in SEC proceedings seeking equitable relief, a cause of action may be predicated on negligence alone,"[9] is dicta.

In *Universal*, an action against an attorney for aiding and abetting the sale of unregistered securities, the Court of Appeals found evidence of wilfulness and said "our decision need not rest on our rejection of appellant's negligence-scienter argument, because the District Court found that appellant in some circumstances knew and in other circumstances had reason to know that his client was engaging in illegal transactions with the aid of appellant's letters and that appellant's acts were performed with knowledge or reckless disregard of the truth. This, we have held, is sufficient to establish scienter."[10]

Exploring the Issue

What the Second Circuit will do with the Commission's request for summary reversal is an open question but, the issue, which already has resulted in several inconsistent opinions by the courts, and is the subject of much litigation,[11] is worth exploring.

At the risk of stating the obvious, but to place the issue in context, *Hochfelder* is distinguishable because it was a private action for damages and, while proof of wilfulness was required, the Supreme Court recognized that the decision does not necessarily control SEC injunction actions in which the Second Circuit, both before and after *Hochfelder*, has said that proof of negligence is sufficient. On the other hand, the Supreme Court in *Hochfelder* said that the language of Section 10(b) of the 1934 Act requires proof of scienter. Thus, at least arguably, as Judge Ward said in *Bausch & Lomb*, there is no Section 10(b) violation without scienter and therefore no ground for an injunction without proof of scienter.

Possible Analysis

It is difficult to say what the Court of Appeals for the Second Circuit or the Supreme Court will do when squarely faced with this issue in an SEC injunction action. One possible analysis of the problem, not made in any of the cases found since *Hochfelder*, would lead to the conclusion that *Hochfelder* does not require proof of a past wilful violation but it does require proof that there is a likelihood of a future wilful violation, at least in connection with those statutory violations in which wilfulness is a necessary element of the cause of action. The analysis starts with the statutory authority for Commission injunction actions.

In such proceedings, as distinguished from private actions for damages, injunctive relief is authorized by statute upon proof that a person "is engaged or about to engage" in illegal acts.[12] There is no statutory requirement of proof of a past violation although such proof is evidence of the probability of a future

Continued on page 3, column 1

violation."[13] Therefore, both before and after *Hochfelder*, the "critical" question to be asked in SEC injunction actions is — what is the likelihood of a future violation?"[14] The test for an injunction under this analysis would be, not whether there has been a past violation as Judge Ward said in *Bausch & Lomb*, although evicence of a past violation is relevant, and not whether the defendant's past conduct has been wilful or negligent, but whether the past conduct makes a future violation likely.

Questions Asked

The question then becomes — how is a likely future violation to be determined in SEC actions after *Hochfelder*? Does *Hochfelder* require that there be sufficient evidence in the record to find that there is a likely wilful violation? Or, on the other hand, is proof that the defendant may be negligent in the future sufficient?

Arguably, *Hochfelder* dictat in Rule 10b-5 cases and under other Sections of the securities laws in which proof of wilfulness is required, there must be evidence in the record in a SEC injunction action of the likelihood of a future wilful violation — evidence that unless enjoined by the Court the defendant will wilfully repeat the violation. The other side of that argument is that the policy of the securities laws to protect investors is best implemented by a negligence standard in SEC injunction cases. The problem with the argument is that it ignores *Hochfelder* in which the Supreme Court said that the language of Section 10(b) requires proof of wilfulness. It is difficult to see how the policy of the law is advanced when it is applied inconsistently with statutory language. We await the Court's decision on this critical law enforcement issue.

SEC v. Bausch & Lomb, Inc., [Current] CCH Fed. Sec. L. Rep. para. 95,722 (SDNY 1976).

(2) 425 U.S. 185 (1976).

(3) See SEC v. Management Dynamics, Inc., 515 F. 2d 801 (2d Cir. 1975); SEC v. Spectrum, 489 F. 2d 536 (2d Cir. 1973); SEC v. Texas Gulf Sulphur Co., 40. F. 2d 833 (2d Cir. 1968), cert. denied sub. nom. Coates v. SEC 394 U.S. 976 (1969); contra SEC. v. Coffey, 493 F. 2d 1304 (6th Cir. 1974) cert. denied, 420 U.S. 908 (1975).

(4) The Commission relies on John Nuveen & Co. v. Sanders, 95 S. Ct. 1965 (1976) in which the Supreme Court summarily remanded a decision of the Seventh Circuit for reconsideration in light of the Supreme Court's decision in Hochfelder, decided after the Seventh Circuit decided Nuveen.

(5) SEC Brief p. 8.

(6) No. 75-6111 (Dec. 16, 1976).

(7) Ibid.

(8) SEC Brief p. 3-4.

(9) No. 75-6111 (Dec. 16, 1976) (Shep Op.)

(10) Ibid.

(11) For example, in SEC v. World Radio Mission, Inc., 1976 CCH Fed. Sec. L. Rep. para. 95,751 (wilfulness is "irrelevant"); SEC v. Parklane Hosiery Co., Inc., 1976 CCH Fed. Sec. L. Rep. para. 95,753 (wilfulness found but no injunction issued because insufficient proof of likelihood of future violation); SEC v. Bausch & Lomb, supra (wilfulness required). See also SEC v. Geotek, 1976 CCH Fed. Sec. L. Rep. para. 95,756.

(12) Section 20(b), Securities Act of 1933; Section 21(e), Securities Act of 1934.

(13) SEC. v. Management Dynamics, Inc., supra; SEC v. Manor Nursing Centers, Inc., 458 F. 2d 1082 (2d Cir. 1972).

(14) SEC v. Management Dynamics, Inc., supra; SEC v. Manor Nursing Centers, Inc., supra; SEC v. Parklane Hosiery Inc., supra.

Mr. Brodsky is a former Assistant U.S. Attorney and a former attorney in the civil division of the Department of Justice. He is the author of a book, "A Guide to Securities Litigation."

STATE OF NEW YORK, COUNTY OF ss.:

The undersigned, an attorney admitted to practice in the courts of New York State,

Check Applicable Box

☐ Certification By Attorney — certifies that the within has been compared by the undersigned with the original and found to be a true and complete copy.

☐ Attorney's Affirmation — shows: deponent is the attorney(s) of record for in the within action; deponent has read the foregoing and knows the contents thereof; the same is true to deponent's own knowledge, except as to the matters therein stated to be alleged on information and belief, and that as to those matters deponent believes it to be true. This verification is made by deponent and not by

The grounds of deponent's belief as to all matters not stated upon deponent's knowledge are as follows:

The undersigned affirms that the foregoing statements are true, under the penalties of perjury.

Dated:

.....
The name signed must be printed beneath

STATE OF NEW YORK, COUNTY OF ss.:

Check Applicable Box

☐ Individual Verification — being duly sworn, deposes and says: deponent is the in the within action; deponent has read the foregoing and knows the contents thereof; the same is true to deponent's own knowledge, except as to the matters therein stated to be alleged on information and belief, and as to those matters deponent believes it to be true.

☐ Corporate Verification — the of a corporation, in the within action; deponent has read the foregoing and knows the contents thereof; and the same is true to deponent's own knowledge, except as to the matters therein stated to be alleged upon information and belief, and as to those matters deponent believes it to be true. This verification is made by deponent because is a corporation and deponent is an officer thereof.

The grounds of deponent's belief as to all matters not stated upon deponent's knowledge are as follows:

Sworn to before me on 19

.....
The name signed must be printed beneath

STATE OF NEW YORK, COUNTY OF ss.:

being duly sworn, deposes and says: deponent is not a party to the action, is over 18 years of age and resides at

Check Applicable Box

☐ Affidavit of Service By Mail — On 19 deponent served the within upon attorney(s) for in this action, at the address designated by said attorney(s) for that purpose by depositing a true copy of same enclosed in a post-paid properly addressed wrapper, in — a post office — official depository under the exclusive care and custody of the United States Postal Service within the State of New York.

☐ Affidavit of Personal Service — On 19 at deponent served the within upon the herein, by delivering a true copy thereof to h personally. Deponent knew the person so served to be the person mentioned and described in said papers as the therein.

Sworn to before me on 19

.....
The name signed must be printed beneath

NOTICE OF ENTRY

Sir:-Please take notice that the within is a *(certified)* true copy of a duly entered in the office of the clerk of the within named court on 19

Dated,

Yours, etc.,

Attorney for

Office and Post Office Address

To

Attorney(s) for

NOTICE OF SETTLEMENT

Sir:—Please take notice that an order

of which the within is a true copy will be presented for settlement to the Hon.

one of the judges of the within named Court, at

on the day of 19

at M.

Dated,

Yours, etc.,

Attorney for

Office and Post Office Address

To

Attorney(s) for

Docket No. 75-6111

Index No. Year 19

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SECURITIES & EXCHANGE COMMISSION,
Plaintiff-Appellee,

-against-

UNIVERSAL MAJOR INDUSTRIES CORP., et al.,
Defendants,

ARTHUR J. HOMANS,
Defendant-Appellant

PETITION FOR REHEARING

Brewer & Soeiro
Attorneys for Appellant
Office and Post Office Address, Telephone
257 Park Ave. So.
New York, N.Y. 10010

To

Attorney(s) for

Service of a copy of the within is hereby admitted.

Dated,

Attorney(s) for

74-1371